Richard Russell's Dow Theory Letters INCORPORATED
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THE PICTURE: The page 1 chart below shows that the 50-day moving average of the Dow is now declining as is the 200-day MA. The Dow is holding below its 200-day MA. If or when the 50-day May drops below the 200-day MA (with the Dow below both) the Dow will move to the fully bearish or "sell" mode. Until then, I consider the trend of the Dow to be neutral. The 50-day MA now stands at 10814 and the 200-day MA stands at 10582.

June 29, 2001, DJIA 10499.71; PTI 5307 A-D Ratio -2.32
July 6, 2001; DJIA 10252.68; PTI 5305; A-D Ratio -2.62
July 13, 2001; DJIA 10539.06; PTI 5321; A-D Ratio -2.51
Dow yield: 1.70; Dow p/e: 22.40; Times Book Value: 6.43
Gold 34-day MA: 270.40

Each day I receive up to a dozen newsletters, advisories and brokerage letters. Many of them offer predictions based on cycles, time spans, sentiment, patterns, you name it. After 43 years of operating in this business, I've learned to ignore most of these reports. Sure, many of them are interesting. Sure, many of them are even convincing. But on the whole, as I said, I ignore them.

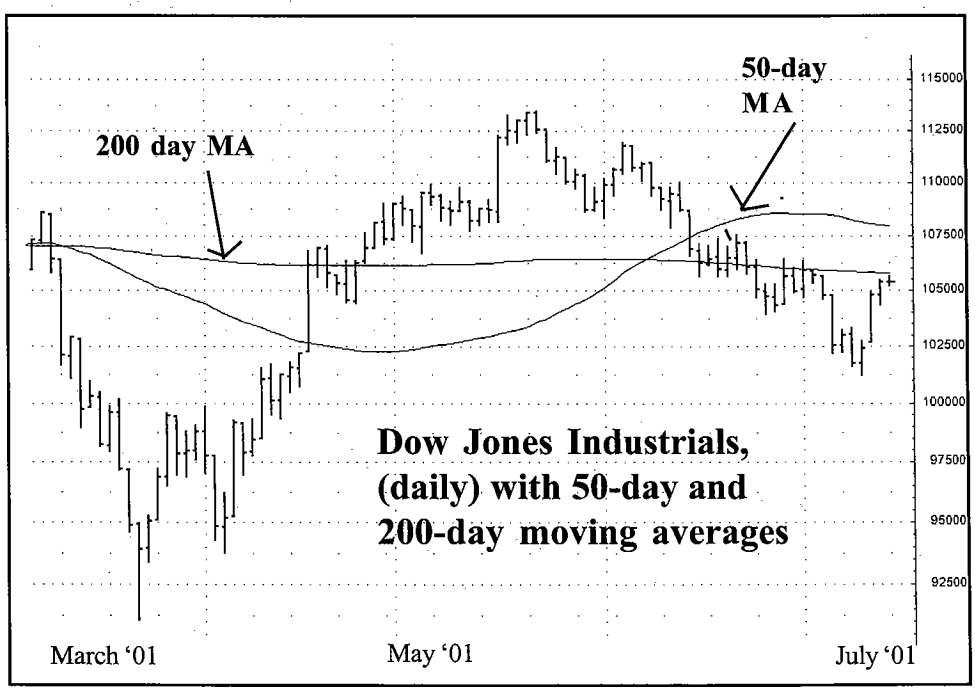
I stay with the Dow Theory, which few people follow today and even fewer understand. I stay with one basic concept. Stocks travel from broad areas of undervaluation to broad areas of overvaluation – and then back again to undervaluation. It's the one syndrome that never fails – you can count on it.

How long each "yield cycle" lasts is unknowable. How high stocks will rise in the bull market segment of the yield cycle is unknowable. How low stocks will sink in the bear segment of the yield cycle is unknowable.

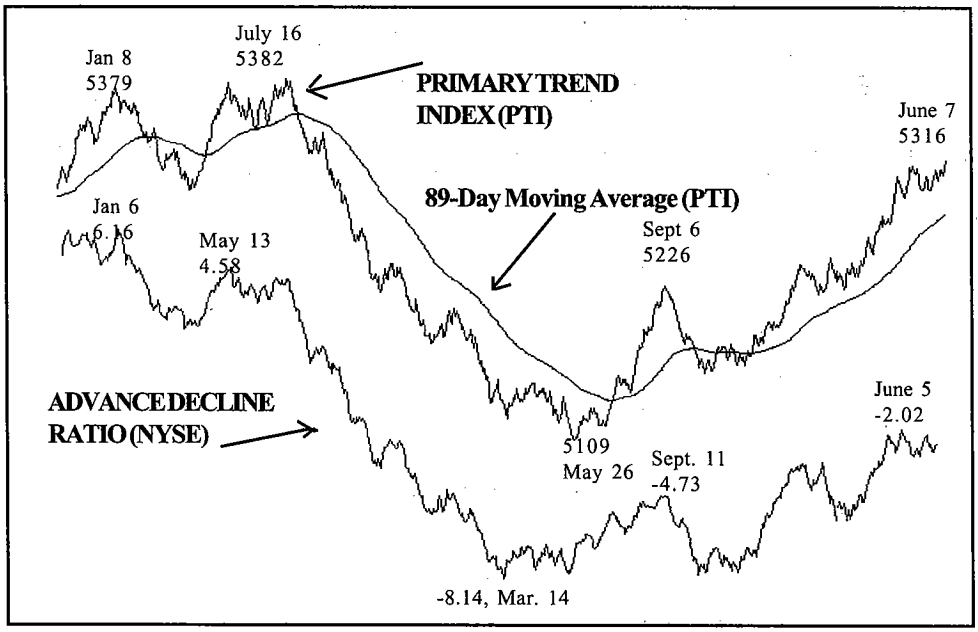
But the unknowable part is not enough for most people or for most analysts. The analysts want to play "genius" and that means telling us what will happen every week, every month, even on a day-to-day basis. Don't waste your time on this sort of work. It's work that doesn't work.

This recent bull market took stocks to unprecedented highs of overvaluation, driving price/earnings ratios on the S&P to over 30 and driving dividend yields down to unprecedented levels in the 1% area.

The top, the area of distribution is now in progress. So far, the top has lasted two years. I don't know exactly how long this distribution area will last – nobody does. But when it's over stocks will embark on a broad, relentless retreat (we've already seen the retreat in one area – tech).



Dow Jones Industrials, (daily) with 50-day and 200-day moving averages



Because the late, great bull market ended with a bubble and accompanying extremes of overvaluation, it's entirely possible (but obviously not certain) that before the current bear market breathes its last, we'll see new records in undervaluation.

In the meantime, I continue to be flooded with all types and brands of advisory information. A lot of it is interesting, some fascinating – but most of it is either short-term, amateurish, useless or even deceptive.

I've warned before and I'll warn again that in a primary bear market many of the old trusted "tools" don't work. The market may appear to be entering a perfect bottoming area, and suddenly the ground gives way and down she goes. The market may grow dull, in which case many amateur analysts will cry, "Never sell a dull market." But that doesn't apply during a primary bear market. In bear markets dull areas usually imply a dearth of buying interest – thus, dull areas in bear markets are often the prelude to the next decline.

This bear market has been particularly deceptive, and I think deceptive for two main reasons. (1) Stockholders have been bullish for so long that they simply can't conceive of a market where stocks should be sold. Thus, declines, so far, in this bear market are often the result of a pull-back in buying rather than active selling. But it takes heavy selling to knock the bull to his knees. We haven't seen that kind of selling yet.

(2) Investors have adopted a sort of mystic feeling about the Fed. The cult of the Fed and its modern-day hero, Alan Greenspan, has literally taken over the investment world. People feel that it's only a matter of time before the Fed (with its machinations) will turn the economy around. "Don't fight the Fed" has been a mantra. But so far this year fighting the Fed has paid off.

The prevailing opinion, I believe, is that the market at the March-April lows has discounted the worst that can be seen ahead. And from now on it's just a matter of which month or which quarter we'll see the long-expected, almost guaranteed upturn in the economy.

The operative thesis here continues to be that this is a primary bear market. The bear market is being "held back" by an almost fanatical belief that "the Fed will not let anything bad happen" plus an ingrained bullish sentiment on the part of investors.

At the latest reading, for instance, we see (from *Investor's Intelligence* statistics) that 51% of advisors are now bullish while only 25% are bearish. This is the lowest bearish percentage since July of 1999.

Turning again to the page 1 chart, we see that the 200-day moving average of the Dow stands at 10580. At the same time, the 50-day MA of the Dow has rolled over and is now trending down. By my method of reading the moving averages, the situation is not clearly bearish until the 50-day MA breaks below the 200-day MA and the item (in this case the Dow) is below both. This has not yet occurred.

It would not surprise me to see the Dow work around the space between its current level and the 200-day MA or between here and 10580 on the Dow.

The current rally should serve to stir up hope and bullishness again and to invite many investors to take another foray back into the market.

As I see it, it's "time out" for the bear market, and "time in" for traders to do their dance. Target for the Dow – running up and "testing" the 10580 level of its 200-day moving average.

INVESTMENT POSITION:
The bear remains in charge.Sadly, I must report that this is still a bear market.

Knowing how to invest here is very difficult. Everyone is used to asking what stocks to buy and what stocks are going to make profits. It seems inconceivable that we may face an extended period of time in which the idea is not to make money (because it's damnably hard to make money in a bear market) but the idea from here on may be just to survive.

Of course, the ideal way to do this ("merely" survive) is to buy US 91-day T-bills and the hell with everything else. If you buy T-bills you have only two worries: the viability of the US government, and the viability of the US dollar.

True, no government lasts forever, but I feel reasonably certain that the US government will be around as long as you and I and our kids are around. So I'll be darned if I'm going to worry about Uncle Sam.

As for the dollar, even if it caves in – if you're in T-bills you're probably doing as well as can be expected. If the dollar crashes, we'll probably be in a state of deflation, in which case most of what you need to live on will be cheaper, and you'll still be in good shape.

Of course, the question may be asked, "If the dollar crashes, what will it crash against?" And the answer will be that it will either crash in value against one or more other currencies (the euro, the yen) or it will crash against gold. Which is why some people insist on holding perhaps 5% to 10% of their assets in gold.

What other alternatives are there? Well, you can buy top-grade muni bonds and simply compound the interest as it comes in (buy more bonds with the interest). If the bonds are top-grade they should pay off at maturity, and if rates go up you'll have to simply ignore the price of the bond and think in terms of maturity.

Compounding is so powerful that as the old story goes – if you continue to compound, then after a certain number of years what you paid for your original investments doesn't matter that much – the compounding effect will more than overcome any losses from your original investments.
So all in all, the safest and easiest way to weather the bear market would be a mix of say 50% T-bills and 50% ten-year T-notes or instead of the T-note, 50% in five to ten-year maturities in top grade municipal bonds.

Remember, you're not going to make a killing in this bear market, so don't even try. What you are trying to do is **survive** while losing as little in the way of total assets as possible. The operative idea during the duration of the bear market are: (1) don't lose money, and (2) bring in income.

FORTUNE: The following is from a very insightful article that appeared in the June 11 issue of *Fortune* magazine. The ideas expressed in this article, I felt, were so important that I wanted my subscribers to read the piece and digest it. Excerpts from the article are below —

"... the current stock market is headed for such nastiness that even a Cassandra will look like a Pollyanna.

"The problem: corporate profits. Forget about the dot-com aberration. Rule No. 1 about the stock market is that over the long term, *share prices track profit growth.* But by one measure — earnings as a percentage of gross domestic product – the *rate of profit growth has peaked.*

"Consider this: After surging in the late-1990s, corporate earnings now equal more than 7% of the nation's total out-

put — already at the high end of the historical range. For profits to grow at the same rate they did during much of the bull market, some long-standing historical models would have to crumble.

"Even at an 11% clip (lower than the growth rate during the late-1990s), earnings would end up totaling 10% of GDP by 2010, says Wharton's renowned finance professor, Jeremy Siegel. "That's something that hasn't happened in 50 years," he says.

"More likely, he notes, profits will merely track the expansion of the economy as a whole. And even optimists don't expect the US GDP to grow much more than 3% a year in the near future. Add 3% inflation, and you have profit growth – and stock appreciation – of 6% a year.

"Of course, stock prices *could* rise faster than earnings – if multiples expand. But that's a big IF. The P/E of the S&P now stands at 25 (Russell comment, it's actually 27.6) compared with an average of 14.4 over the past 66 years (And face it: We're not going back to those absurd bubble P/Es, at least not anytime soon). So if multiples hold steady – an optimistic scenario, as we'll see in a minute – stock prices can only rise as fast as profits: 6% a year. Throw in 1.2% for dividends, and investors reap long-term annual returns of 7.2% a year. Keep that in mind.

"Now it is possible that investors will accept such modest returns. After all, half of all Americans own stocks. They no longer view equities as mysterious, ultra-high risk investments. Still, 7.2% annually would require a major adjustment in the mindset of shareholders. It would be an unexciting world where prices grow slowly and steadily, says Cliff Asness, head of AQR Capital Management, a NYC money manager. Equities would have to behave like low-grade bonds.

"It isn't much of a stretch. A 7.2% return gives shareholders a mere 1.4% more than the 5.8% they can now earn on ultra-safe long-term government bonds – a stark departure from the past, certainly.

"Since the 1920s this spread in returns – the so-called risk premium – has averaged 7.8% according to Ibbotson Associates. That's *six times* the current spread. In other words, investors have historically received an extra 7.8% return to buy stocks instead of government bonds. Ask yourself this question: Why would investors suddenly decide it's OK to accept so much less for holding an investment that is obviously riskier?

"Economists Eugene Fama of the University of Chicago and Kenneth French of MIT don't think they will. In a new study, Fama and French assessed half a century of stock market data and concluded that, over time, investors require a premium of roughly 3.5% to hold equities. Add that to the 5.8% risk-free government bond rate, and you end up with a total return of 9%.

"The most obvious way to get there? Stocks must first drop – *and far* – before they can rise at rates Joe Investor would accept. To raise annual returns to the 9% level, from the boring but anticipated 7.2%, the S&P would have to shed – put down your coffee for this one – 60% of current value. The benchmark index would have to drop from around 1,300 now to close to 500, cutting multiples from 25 to10.

"Of course, it's possible that the crash wouldn't happen all at once – that instead it would be a lengthy, painful process. Stock prices could simply rise more slowly than earnings for the next several years, lowering multiples and making room for faster price appreciation after 2010. We'll have a world of low, steady returns, or a huge correction followed by bigger gains, warns Asness. Not exactly the most tempting options.

"So are we better off out of the market, avoiding the risk altogether? By this analysis, it sure looks that way. Still, that doesn't mean you have to stay away from stocks forever. Even under this gloomy scenario, there's no reason you couldn't put your money in long-term bonds and wait for the fall – and the chance to pick up stocks at 40 cents on the dollar. Hey if the apocalypse doesn't come, all you lose is that extra 1.4% a year. Not a big price to pay, Cassandra, for a few good nights of sleep."

Russell Comment: This is a very important article, reasoned and logical. It also fits in with history. History suggests that after a huge bull market (1982 to 2000) with accompanying massive public participation, the market will, one way or another, drive the public out of the market, drive them back to serious work in their own fields.

The stock market has never been a rose garden for the public decade after decade. There's an old saying, "The purpose of a bear market is to send stocks back to their rightful owner — Wall Street."

This is what I expect to happen. The idea is to leave with profits, not with anger and regrets. The age of super-high multiple stocks paying no dividends is slowly but surely on its way out. The bear will ultimately drive the public out of the market, CNBC will fizzle and fade, the *Wall Street Journal's* circulation will shrink, and Americans will go back to hard work in useful fields. Wall Street, battered and torn, will slowly lay the groundwork for the next great bull market. And those who have studied history will prosper.

NOTES & QUOTES: For the first time since the 1950s Brooklyn, NY, has a baseball team. Sure, it's not a major league team, but it's baseball, and it's being played at the new Coney Island stadium. In many ways, baseball became "the national pastime" in the heart of New York's largest borough. It was a city within a city with a mixture of Irish, Italian and Jews. It was in Brooklyn that the racial barrier in baseball was broken. The Brooklyn Dodgers hired the great Jackie Robinson, and history was made.

To show you how young I am, at my first baseball game I saw Babe Ruth hit a homer, I saw Lefty Gomez and Carl Hubbel in action. That was back in the '30s, but I forget which year it was.

* * *

Not everyone lost during the Nasdaq collapse. In fact, quite a few Silicon Valley executives took profits when near the highs. The money they pulled in was often astronomical.Here are the top ten, as per the *San Jose Mercury News* (June 17). Ramond Lane of Oracle cashed out for $233 million. John Chambers of CSCO took in $157 million. Don Pettit of JDS Uniphase took in $121 million. David Peterschidt of Inktomi-$107 million. Kevin Kalkhoven of JDS Uniphase-$106 million. W.J. Sanders of Adv. Micro Devices-$92 million. Steven Jobs of Apple $90 million.Thomas Siebel of Siebel Systems $88 million. Jeff Henley of Oracle $78 million. Larry Ellison of Oracle $75 million. Who said the Nasdaq was a disaster? It wasn't if you had enough options and were smart enough to sell 'em near the highs – when the public was screaming for more IPOs.

* * *

I receive *S&P's* weekly publication, "The Outlook." They show their "Platinum Portfolio" of 25 of their top picks in stocks. Of the 25, only two pay anything at all in the way of dividends. The two are Clayton Homes with a dividend of 0.5% and Tyco International with a dividend yield of 0.3%. The other 23 stocks yield zip, nothing.

I won't buy a stock unless it has a dividend. That's because I believe thoroughly in compounding rather than betting on growth or appreciation. Without dividends, I can't compound.

Why do I adhere to this philosophy of investing? Because growth in earnings or stock appreciation is never certain. Compounding is certain, as certain as the statistics in a book of compounding tables.

Nothing reflects a corporation's health more than a long record of increased dividends (GE has followed this policy for years). Also, the trend of dividend increases or decreases can tell us a lot about general corporate health in the nation. Along these lines, Standard & Poor's reported that dividend payments this year are expected to fall by 6.6% over last year, and last year's payments were down 2.5% from the year before.

The 6.6% drop in corporate dividend payments would be the worst since 1942 when the outcome of World War II was in doubt. I take the 6.6% drop in dividend payments as a serious sign, a sign that US corporations are in a profit squeeze and are desperate to conserve cash.

* * *

The table below is an interesting projection of population trends, showing where the world was in 1950, where it is today – and where it should be in 2050.

Population in Millions								
1950			2000			2050		
1.	China	554.8	1.	China	1,275.1	1.	India	1,572.1
2.	India	357.6	2.	India	1,008.9	2.	China	1,462.1
3.	U.S.	157.8	3.	U.S.	283.2	3.	U.S.	397.1
4.	Russia	102.7	4.	Indonesia	212.1	4.	Pakistan	344.2
5.	Japan	83.7	5.	Brazil	170.4	5.	Indonesia	311.3
			9.	Japan	127.1	16.	Japan	109.2

In 2050 India will have the world's largest population, China will be next, and the US (with the help of immigration) will be third, up 40% from where we are now. Note that Japan's population is due to shrink, down from a current 127 million

to 109 million, 50 years from now. (Source: "World Population Prospects, the 2000 Revision," United Nations Population Division).

* * *

Have you seen the numerous full page ads for the movie, "Sexy Beast"? Faye and I saw the film last week. The ads shout, "100 ways to say the killer performance of the year. Ben Kingsley deserves an Oscar nomination." We saw the picture and wondered what all the hype was about. My opinion – a fair picture, much of it close to being boring. Frankly, I've never seen so much advertising hype about a so-so flick. I guess with so many "nothing" movies coming out this year, the makers of "Sexy Beast" thought they at least had a movie for grown-ups, so why not hype it to the skies.

* * *

NEW, at least new with us. In addition to the daily Remarks which are posted on our web site daily, we have started posting this Letter on our Internet site as well. This means that subscribers will receive the Letter much earlier instead of waiting for what's left of the US Post Office to deliver the mail. That is all conditional on you readers going to the web site, clicking on "Dow Theory Letters" in the Member's Area under "Richard's Remarks." You also need Adobe Acrobat Reader to "read it" and it can be downloaded to your computer from our site. (Hint to our web readers: print off the Letter for the best view of charts/graphs, etc.)

I think this Letter's new format is a bit imperfect, but be patient, and we'll get it right, hopefully within the next Letter or so.

Of our 7,000 subscribers, 80% are on the net and reading the daily site pieces each day. But that leaves about 1200 subscribers who either hate computers, are afraid of computers, or who simply will have nothing to do with computers for reasons of their own.

Nevertheless, each day we receive calls from subscribers who want passwords so they can get on the net and read our daily sites. We keep hoping that in due time all our subscribers will become computer-savvy. Listen, if I can do it at my age anyone can do it.

* * *

Ever wonder how much of the nation the US government owns? Check these figures out. The US owns 83% of the state of Nevada, 63% of Utah, 62% of Idaho, 62% of Alaska, 52% of Oregon, 50% of Wyoming, 45% of Arizona, 44% of California, 36% of Colorado, 34% of New Mexico, 28% of Montana and 28% of Washington. That's one heck of a lot of land that Uncle Sam owns and controls.

* * *

At the gym we hear and talk to many local La Jolla brokers, brokers from a good many different firms (La Jolla has offices from every major brokerage firms). From what I gather, the brokerage business is "dead in the water," with most of them down 50% or more.

HISTORY: The market turned up in 1982 and for 18 years it pushed generally higher with investor's enthusiasm rising with stocks. In December 1996 Fed Chairman Greenspan issued his famous "irrational exuberance" warning, and literally from that point on the market turned from an overvalued market to a bubble market. The arrival of Internet enthusiasm led to the greatest era of speculation in US history.

Then came the crushing decline in the Nasdaq along with month after month (starting in April 1998) of declining breadth and eroding stock values on the NYSE.

But the enthusiasm and optimism of an 18-year bull market is not going to die in a month or a year. It's going to take time. What I believe we're seeing in this two-year Dow trading range, is the slow, very slow stamping out of investors' hopes and bullishness. But the bullishness and hopes are still far from extinguished. It's obviously going to take more time.

I believe the sign or signal for the final extinguishing of bullishness will come when the Dow breaks below its trading low of the last two years. The low of the trading range was the March 22, 2001 closing low of 9389.48. My guess is that the Dow will have to break under that low and probably under 9000 before the ingrained bullishness of today is completely erased.

LATE NOTES: The only new high that I see is the muni futures contract. Today (July 16) the Sept. muni futures rose to 104.05, a new high for the year. Wanted -- income, tax free income!

Stocks have been locked in a trading range for two-and-a-half years. The broad S&P is where it was in April of '99. At some point the stock-buying public is going to disbelieve in the bull market. At that point they will cut back on their buying. At that point, Alan Greenspan will have nightmares.

NEXT MAILING: August 8, 2001